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Supreme Court, U.S.
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No. 091409

In the

Supreme Court of the United States

JOHN J. WARREN and JAMES K. WARREN,
Petitioners,

v.

FEDERAL INSURANCE COMPANY,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the abuse of discretion standard is rendered meaningless by the Sixth Circuit decision precluding the plaintiffs from deposing any and all fact witnesses, particularly an employee of the insurance company who interpreted the insurance contract and denied the plaintiffs' request for coverage.

2. Whether a federal court, in a diversity action, may ignore and change the Ohio Supreme Court's well established rules of insurance contract interpretation, which require that all inferences be made in favor of the policy holder, and instead be permitted to create a new rule of interpretation favoring the insurance company.

PARTIES TO THE PROCEEDING

Petitioners, John and James Warren were plaintiffs in the district court and appellants in the court of appeals. Respondent Federal Insurance Company was the defendant in the trial court and the appellee in the court of appeals.

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PETITION FOR A WRIT OF CERTIORARI

John Warren and James Warren respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The decision of the Court of Appeals denying rehearing (App. 35a - 36a) is unreported. The opinion of the Court of Appeals (App. 1a - 15a) is reported at 2009 FED App. 0822N (6th Cir.). The opinion and order of the District Court (App. 16a - 31a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 22, 2009 (App. 1a-15a), and a timely petition for rehearing was denied on February 17, 2010 (App. 35a-36a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RULE AND THE *ERIE* DOCTRINE INVOLVED

The discovery rules of the Federal Rules of Civil Procedure (Rules 26 et seq.) are to be accorded broad and liberal treatment to effect their purpose of adequately informing litigants in civil trials. Federal Rule of Civil Procedure 26(b) provides in relevant part that deposition-discovery should appear "reasonably calculated to lead to the discovery of admissible evidence." This case also involves the doctrine enunciated in *Erie R.R. v. Tompkins,* 304 U.S. 64 (1938) that a federal court, sitting in diversity, should

follow the state law as set forth by the state's highest court.

PRELMINARY STATEMENT

This case involves an insurance company's denial of a claim submitted by the officers of its insured, a business entity, under a directors and officers' liability policy. The court below not only denied the Petitioners' their right to depose key fact witnesses, but it also disregarded the law in the State of Ohio as it relates to insurance contract interpretation. And by upholding the district court's decision, the Sixth Circuit's ruling throws the law in Ohio governing insurance contract interpretation into complete confusion. Moreover, it flies in the face of the broad discovery rules by prohibiting a plaintiff from deposing fact witnesses.

This square conflict concerning insurance contract interpretation that exists between the Ohio federal and state courts means that, until this Court resolves this issue, courts reviewing insurance contract controversies cannot be sure what criteria to apply. Furthermore, the Ohio federal courts have thrown the concept of broad discovery into question by undermining the basic right to depose fact witnesses. It is critically important for courts and litigants to know whether the Sixth Circuit's decision concerning these issues is right or wrong.

STATEMENT OF THE CASE

1. Background Facts

Petitioners, John and James Warren (the "Petitioners") are brothers who were owners and officers of Prime Measurement Products, LLC ("Prime"). In May, 2005, the Petitioners sold their ownership interest in Prime and resigned as officers.

PNC Bank, N.A. ("PNC") provided Prime with a line of credit. The Petitioners each signed a limited personal guaranty in the amount of $700,000 to PNC with regard to the line of credit.

After the Petitioners left Prime, its financial condition deteriorated. On January 20, 2006, PNC obtained a cognovit judgment in the amount of $700,000 against the Petitioners in state court. The Petitioners immediately challenged the cognovit judgment, filing a motion to vacate the judgment.

In a letter dated March 22, 2006 (the "March 22nd Letter"), PNC asserted a new claim against Petitioners. PNC charged that it was financially harmed by the Petitioners' alleged acts of accounting malfeasance while they were officers of Prime. The letter from PNC's legal counsel stated in pertinent part:

> 5. In addition to your clients' liability to PNC as set forth above (under the guaranty and with respect to the purchase of their interest in BIS Holdings), we believe that the Warrens were responsible for misrepresentations regarding Prime's inventory which affected (a) the

> borrowing base certificates provided to PNC, and (b) Prime's financial statements upon which PNC relied. We currently are evaluating PNC's rights and remedies with respect to these misrepresentations.

The Petitioners immediately notified Prime's directors and officers' (D&O) insurer, Federal Insurance Company ("Respondent"), of this accounting malfeasance claim requesting coverage.

On August 8, 2006, Respondent, through its employee, Michael Joyce, denied coverage for the Petitioners. Importantly, Respondent *never* stated, in its denial letter, that the March 22nd Letter did not rise to the level of a D&O Claim as defined in its Policy. Under the Policy, a D&O Claim is defined as "a written demand for money." Rather, Respondent merely stated that the personal guaranty was not a covered claim.

Eventually, with the assistance of private mediator, the Petitioners and PNC entered into a settlement agreement on June 27, 2007, resolving all disputes including both the guaranty and the accounting malfeasance claims. Under the settlement, the Petitioners agreed to pay PNC $300,000 for any claims of accounting irregularities and any other alleged malfeasance and $50,000 relating to the personal guaranty. These amounts were determined by a ratio of the potential losses for each claim.

II. Decisions of the District Court

The Petitioners filed suit against Respondent for breaches of its duty to defend and indemnify

Petitioners under the D&O Policy for the accounting malfeasance claims charged by PNC in state court. Respondent removed the case to federal court based on diversity of citizenship and raised, for the first time, that the claim of accounting malfeasance as set forth in the March 22nd Letter never amounted to a D&O Claim as defined in the Policy.

During the case management conference, the District Court bifurcated the contractual coverage claim from the bad faith claim, permitting only discovery on the coverage claim. Petitioners noticed depositions for two witnesses: (1) Michael Joyce, the Respondent's employee who signed the letter sent to the Petitioners denying coverage under the Policy; and (2) a Fed.R.Civ.P. 30(b)(6) representative of Respondent. Without an opinion or explanation, the District Court granted Respondent's motion for a protective order precluding these two depositions. (App. 34a) Yet later, in its reply brief, Respondent submitted an affidavit of Michael Joyce.

The District Court subsequently granted summary judgment in favor of Respondent determining that the March 22nd Letter did not rise to the level of a D&O Claim under the terms of Policy, based in part on reliance of the Michael Joyce affidavit as to what evidence would be weighed by the Court in deciding the coverage issue.

III. Decision of the Sixth Circuit Court of Appeals

The Petitioners appealed the District Court's decision on summary judgment as well as its preclusion of allowing the Petitioners to take any and

all depositions. The Petitioners also appealed the District Court's decision to bifurcate the case. The Sixth Circuit Court (Clay, Merritt, and McKeague) held that the District Court did not abuse its discretion in bifurcating the case. However, the Court of Appeals did not directly address the issue of prohibiting Plaintiff from taking depositions. Instead, the Court of Appeals hid the issue by stating, incorrectly, that the District Court had stayed discovery, which it did not on coverage issues.

With regard to the coverage claim, the Sixth Circuit refused to follow the 85 years of Ohio Supreme Court precedent holding that, when interpreting insurance contracts, all inferences are to be construed in favor of the insured. Instead, the Sixth Circuit Court created a new heightened standard of review of an insurance contract whereby all inferences are now to be taken in favor of the insurance company in cases where there is a perceived incentive for the insured to shift the liability from the non-covered claim to the covered claim. Under this new rule of insurance contract interpretation, the Sixth Circuit Court upheld the District Court's opinion that the March 22nd letter did not constitute a D&O Claim under the insurance contract.

REASONS FOR GRANTING THE PETITION

Petitioners respectfully submit that there are two reasons why this Court should grant their petition for writ of certiorari and review the Sixth Circuit Court of Appeal's decision. First, as applied by the Sixth Circuit, the abuse of discretion standard is meaningless. As used by the Court of Appeals, the standard is but a whim of the reviewing court, casting

aside the underlying legal principles at issue – in this case, the right to cross-exam witnesses and establish one's claim through discovery. While the meaning of the abuse of discretion standard is not as glamorous as a constitutional issue – it is just as important -- being utilized by reviewing courts in most appeals. And yet, there is no clear directive on how this standard should be applied. Without such guidance, courts use the standard simply as a crutch to support the end result they desire rather than critically analyzing the principle at stake.

Second, without decision or reasoning, the Sixth Circuit Court simply refused to follow Ohio law as determined by the Ohio Supreme Court in countless cases. Instead, the three judges, none of them from Ohio, created a new standard of review for insurance contract interpretation which strongly favors the insurance companies -- the very ones that write and interpret their own policies in determining whether a claim is covered. The Sixth Circuit never discussed the *Erie* doctrine or seemed to understand the implications of their decision on Ohio law.

I. The Sixth Circuit Rendered the Abuse of Discretion Standard Meaningless.

The abuse of discretion standard is a notoriously ambiguous rule designed primarily to allow trial courts to manage their dockets and proceedings without the minute second guessing of appellate judges. The rule is implicated in the majority of appeals. Despite the frequency of these issues, courts are applying it in an ever increasing haphazard fashion – utilizing a very subjective standard to arrive at the result desired rather than analyzing and upholding the legal

principles that the standard is being applied against. This is clearly demonstrated by the Sixth Circuit's decision in this case when juxtaposed with a previous decision by the same court just months earlier in *Conti v. Am. Axle and Mfg., Inc.*, 326 Fed. Appx. 900 (6th Cir. 2009)(Clay, Circuit Judge).

In this case, the Sixth Circuit gutted any meaning to the abuse of discretion standard by permitting the trial court to prohibit all depositions in this insurance coverage case, without explanation. The Sixth Circuit attempts to hide its decision by not directly addressing the point in its opinion. But, the holding is clear – the district court did not abuse its discretion when it prevented the Petitioners from taking any and all depositions of fact witnesses – particularly, the Respondent's employee who denied the Petitioners' request for coverage. And, although they prohibited the Petitioners from taking any depositions of the Respondent, the courts allowed the Respondent to submit an affidavit from this same insurance company employee.

In contrast, the Sixth Circuit, in *Conti,* held that it was an abuse of discretion to deny the plaintiff the ability to take the deposition of a person with integral knowledge of the facts and issues in the case. In *Conti,* the defendant, a multi-national corporation, sought to preclude the deposition of its CEO in a gender discrimination and retaliation claim asserted under Michigan law. The district court agreed opining that the CEO was never plaintiff's direct supervisor. Judge Clay, who also served on the Panel in this cases, wrote the opinion holding that the district court had abused its discretion in denying the deposition because the CEO had some knowledge that may be relevant to the

plaintiff's case. The Court held that "[i]t is very unusual for a court to prohibit the taking of a deposition altogether and absent extraordinary circumstances, such an order would likely be in error." *Conti*, 326 Fed. Appx. at 907-908 (citing *Salter v. Upjohn Co.*, 593 F.2d 649, 651 (5th Cir. 1979)).

Under Fed.R.Civ.P. 26(b), a party has broad rights to conduct discovery, including depositions, to discover evidence that is reasonably calculated to lead to admissible evidence. *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 (1978); Fed.R.Civ.P. 26(b). Protective orders totally prohibiting a deposition should rarely be granted absent extraordinary circumstances. *Bucher v. Richardson Hosp. Auth.*, 160 F.R.D. 88 (N.D. Tex. 1994); *West Peninsular Title Co. v. Palm Beach County*, 132 F.R.D. 301, 302 (S.D. Fla. 1990); 4 Moore & Lucas, Moore's Federal Practice P 26.69 (3d ed. 1976); 8 Wright & Miller, Federal Practice & Procedure § 2037 (1970).

A party seeking to quash a deposition in its entirety has a heavy burden of demonstrating good cause, which means showing "extraordinary circumstances" based on "specific facts" that would justify such an order. *Prozina Shipping Co. v. Thirty-Four Autos.*, 179 F.R.D. 41, 48 (D. Mass. 1998); *Investment Properties Int'l, Ltd. v. IOS, Ltd.*, 459 F.2d 705, 708 (2d Cir. 1972)("an order to vacate a notice of taking is generally regarded as both unusual and unfavorable"); *Motsinger v. Flynt*, 119 F.R.D. 373, 378 (M.D.N.C. 1988) ("Absent a strong showing of good cause and extraordinary circumstances, a court should not prohibit altogether the taking of a deposition.").

Here, the District Court, without any opinion or reasoning, denied Petitioners their right to take any and all depositions, particularly that of Michael Joyce. In his denial letter of August 8, 2006, Mr. Joyce **never** stated that the March 22nd Letter was not a "D&O Claim" as defined by the Policy. That defense was not asserted in any manner until Respondent's attorneys filed an answer to the complaint. Accordingly, the Petitioners wanted to ask Mr. Joyce, among other facts:

1. When issuing your August 8, 2006 denial letter, did you consider the March 22nd Letter constituted a "Claim" under the Policy?

    a. If yes, then Respondent's affirmative defense asserted in its Answer is nullified.

    b. If no, why didn't you mention that the March 22nd Letter did not constitute a Claim?

2. What material did you rely upon in denying the claim?

3. Did you even review the March 22nd letter before denying the claim, since you only mention the cognovit judgment?

These inquiries go to the very heart of whether there is or should have been coverage under the terms of the Policy. If there was any doubt as to how the March 22nd Letter was interpreted by Respondent when it denied coverage, it could only be resolved by

the person who denied coverage and failed to mention that the March 22nd Letter did not constitute a Claim.

Most striking is that after all of Respondent's protests, Respondent submitted an affidavit of Michael Joyce in its reply brief supporting its argument for summary judgment. Mr. Joyce's affidavit provided some facts as to what was considered or not considered in denying the claim. Not surprisingly, Mr. Joyce's affidavit only spoke to those facts supporting Respondent's position, without the benefit of cross-examination to explore those facts.

This is patently unfair and undermines some of the principles at the bedrock of our legal system and in direct conflict with this Court's earlier decision of *Conti* and the Fifth Circuit's decision of *Salter*, which the *Conti* Court cited with approval. Under the Sixth Circuit's reasoning, neither litigants nor district court judges have any idea when certain conduct will be considered an abuse of discretion.

II. The Sixth Circuit Disregarded Well-Established Ohio Law to Create a New Standard of Insurance Contract Interpretation.

In its decision, the Sixth Circuit ignored this Court's directive in *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938) and changed over 85 years of Ohio precedent by throwing out the Ohio Supreme Court's well-established rules of interpretation for insurance contracts, whereby all inferences and ambiguities in the insurance contract are to be construed in favor of the insured. After creating a new heightened standard of review for insurance contracts under Ohio law, the

Sixth Circuit proceeded to make several inferences in favor of the Respondent to support its ruling against the Petitioners. The Sixth Circuit improperly disregarded the Ohio Supreme Court's precedent, which controlled the resolution of this case, to reach its desired result.

The United States Supreme Court has repeatedly held that federal courts, sitting in diversity, must apply state law in accordance with the then controlling decision of the highest state court. *Vanderbark v. Owens-Illinois Glass Co.*, 311 U.S. 538, 543 (1941); *Erie*, 304 U.S. 64; *United States v. Anderson County, Tenn.*, 761 F.2d 1169, 1173 (6th Cir. 1985).

As early as 1924, the Ohio Supreme Court held that "[p]olicies of insurance which are prepared by the insurance company and which are reasonably open to different interpretations will be construed most favorably to the insured." *Ohio Farmers Ins. Co. v. Wright*, 246 N.E.2d 552, 555 (Ohio 1969); *Gibbons v. Metropolitan Life Ins. Co.*, 21 N.E.2d 588, 591 (Ohio 1939); *Great American Mut. Indem. Co. v. Jones*, 144 N.E. 596 (Ohio 1924) . Although an insurance policy is a contract and the parties' rights under the policy are purely contractual in nature, Ohio courts in insurance contract actions apply rules of contract construction that strongly favor policyholders. *Safeco Ins. Co. of Am. v. White*, 913 N.E.2d 426, 430-1 (Ohio 2009). Where provisions of an insurance contract are reasonably susceptible to more than one interpretation, courts will construe them strictly against the insurer and liberally in favor of the insured. *Hacker v. Dickman*, 661 N.E.2d 1005, 1006 (Ohio 1996)(citing *King v. Nationwide Ins. Co* , 519 N.E.2d 1380, syllabus (Ohio 1988)); *Lester v. State*

Farm Mut. Auto. Ins. Co., 580 N.E.2d 793, 795 (Ohio Ct. App. 1989)("any reasonable construction which results in coverage of the insured must be adopted by the trial court").

In its decision, the Panel not only ignored these principles taking all inferences and construction of the insurance policy in favor of Respondent, but actually changed the principle – now requiring a heightened review -- when the court "perceives or infers" that there is an incentive on the part of the insured to shift liability from a non-covered to a covered claim under the insurance contract.

The Sixth Circuit held:

> It is in the interest of both the plaintiffs and PNC Bank to set up Federal Insurance as a source of payment for the suretyship obligation, and the settlement agreement between PNC Bank and plaintiffs reflects that joint interest. But in situations of this kind, we must be conscious of these interests and require strict compliance with the insurance contract before shifting payment to the insurance company for what appears to be a personal debt that the insurer has not agreed to reimburse. [App. 15a]

In both adopting and applying this new heightened standard, the Panel took all inferences in favor of Respondent. First, The Panel improperly inferred that the settlement agreement between Petitioners and PNC and the allocation of the settlement amount between the covered claim (accounting malfeasance) and uncovered claim (cognovit guaranty) was somehow a sham to shift the cost of the settlement onto

Respondent. Yet, there was no evidence supporting this inference. In fact, there was evidence to the contrary – the agreement was mediated by a well-respected private mediator and was based on a ratio of the potential damages from each claim.

The Panel also took inappropriate inferences to conclude that the March 22nd Letter did not amount to a D&O Claim. Any reasonably prudent person receiving the March 22nd Letter would understand that PNC was claiming that it was harmed by accounting malfeasance and that it was going to hold him accountable. Other courts facing similar language have all concluded that a written demand for money was made. See *Precis, Inc. v. Federal Ins. Co.*, 184 Fed. Appx. 439, 440 (5th Cir. 2006); *Berry v. St. Paul Fire & Marine Ins. Co.*, 70 F.3d 981, 982 (8th Cir. 1995); *Herron v. Schutz Foss Architects*, 935 P.2d 1104, 1108 (Mont. 1997); *Federal Ins. Co. v. Uni-Marts, LLC*, No. 3:07-01357, 2008 U.S. Dist. LEXIS 47801 (M.D. Pa. June 18, 2008)(Respondent took the exact opposite position in this case).

When Respondent eventually denied the claim, it did not state that the March 22nd Letter was not a D&O Claim. Despite never raising this basis for denying Petitioners' claim, the Panel refused to allow the Petitioners to provide additional evidence to dispel any ambiguities of the March 22nd Letter. If Respondent can raise new defenses to deny coverage, then under Ohio law, the Petitioners should be able to present new evidence to address that issue. By not permitting the Petitioners to offer new evidence, the Panel dramatically shifted the balance in favor of the insurance company. Accordingly, the Panel's decision ignores the *Erie* mandate by changing over 85 years of

Ohio precedent and ignores the reality that insurance companies routinely face situations of providing a defense and indemnification to an insured when there are both covered and uncovered claims.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Dated: May 18, 2010

Respectfully submitted,

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APPENDIX A

NOT RECOMMENDED FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 08-4448

[Filed December 22, 2009]

John Warren and James Warren,	)
	)
Plaintiffs-Appellants,	)
	)
v.	)
	)
Federal Insurance Co.,	)
	)
Defendant-Appellee.	)
	)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO

BEFORE: Merritt, Clay, and McKeague, Circuit Judges.

MERRITT, Circuit Judge. This is an appeal from a grant of summary judgment to defendant Federal Insurance Company concerning a dispute over insurance coverage. Plaintiffs John and James Warren

filed suit against Federal Insurance after the company denied coverage to the Warrens under the directors and officers liability section of a policy issued to the Warrens' former company, Prime Measurement Products, LLC. The primary issue on appeal is whether language in a letter sent to plaintiffs by PNC Bank advising that the bank was "evaluating" its rights and remedies with respect to possible financial misrepresentations by plaintiffs triggered a duty to defend and indemnify by Federal Insurance under Ohio law. The district court found that the letter sent to plaintiffs did not present a claim under the plain language of the policy and did not obligate the insurance company to defend or indemnify plaintiffs. We agree with the district court and base our opinion on the reasoning of the lower court.

I. Facts

Plaintiffs John (a/k/a "Jeff") and his brother James (a/k/a "Jamie") Warren, through a limited liability company, The Warren Group, LTD, owned a 50% interest in BIS Holdings, LLC. The George Hofmeister Family Trusts owned the remaining 50%. BIS Holdings is a holding company that held all the interest in Prime Measurement Products, LLC. Prime Measurement was a manufacturer of measurement tools and control sensors for the oil, gas and process markets. The Warrens were officers and directors of both BIS Holdings and Prime Measurement from mid 2001 until May 2005. On February 24, 2004, Prime Measurement obtained a revolving line of credit from PNC Bank that permitted Prime Measurement to borrow money for working capital purposes based on a formula that included, but was not limited to, the book value of Prime Measurement's inventory. Both

John and James Warren signed a personal guaranty on the line of credit. The personal guaranty contained a "cognovit" provision, which allows the bank to enter a judicial confession of judgment.

In addition, BIS Holdings purchased a comprehensive general liability insurance policy from defendant, Federal Insurance,[1] which included directors and officers liability coverage. The policy covered BIS Holdings and its subsidiaries, including Prime Measurement, and the policy was in effect from July 1, 2005 to August 1, 2006.

In May 2005, plaintiffs, through their company The Warren Group, LTD., sold their ownership in BIS Holdings (including Prime Measurement, which was a subsidiary of BIS Holdings), leaving control of the company in the hands of The Hofmeister Family Trusts. For approximately six months after the sale of BIS Holdings (and its subsidiary Prime Measurement), both plaintiffs performed various services for BIS Holdings and Prime Measurement, including John Warren's service as interim CEO of Prime Measurement until July 2005 (two months after the sale of Prime Measurement). In mid-to-late 2005, after plaintiffs had sold their interest in and were no longer actively managing Prime Measurement, the company's financial condition started to deteriorate, causing PNC Bank to advise plaintiffs that certain events of default occurred relating to the revolving line of credit. PNC Bank demanded that plaintiffs fulfill their obligations under the personal guaranty. Plaintiffs refused and

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[1] The "Chubb Group" is a trade name used by Federal Insurance, but it is not a separate legal entity.

PNC Bank filed a complaint in Ohio state court based on the personal guaranty signed by both plaintiffs. *PNC Bank N.A. v. Jeff J. Warren and James K. Warren*, No. 06-CV-144885 (Lorain Cty. Com. Pleas Ct. Jan 20, 2006). There were no allegations in the complaint relating to any misrepresentations or other improper or negligent actions on the part of plaintiffs. Based on the cognovit provision in the guaranty, judgment was automatically entered against plaintiffs in the amount of $700,000. The Warrens immediately filed for a stay of execution on the judgment and a motion to vacate the judgment, citing numerous defenses.

On March 22, 2006, plaintiffs' attorney, Thomas Muzilla, received a letter from a PNC Bank regarding various issues, mostly relating to the guaranty. The letter, however, included the following paragraph:

> In addition to your clients' liability to PNC as set forth above (under the guaranty and with respect to the purchase of their interest in BIS Holdings) *we believe that the Warrens were responsible for misrepresentations* regarding Prime's inventory which affected (a) the borrowing base certificates provided to PNC, and (b) Prime's financial statements upon which PNC relied. *We are currently evaluating PNC's rights and remedies* with respect to these misrepresentations.

(Emphasis added.) On or about April 20, 2006, Prime Measurement, through its local insurance broker Hylant of Indiana, LLC, notified Federal Insurance of a claim being made against the Warrens via an electronic claim system. In the section titled "Loss

Description," Buffy Thomas of Hylant insurance company wrote:

> Specialty – D&O Other – PNC Bank has delivered written notice to former officers, Jeff & Jamie Warren, were [sic] responsible for misrepresentation regarding Prime's inventory which affected the borrowing base certificates of Prime provided to PNC and Prime's financial statements, each of which PNC relied upon in making loans to Prime. The Warrens deny the allegations of PNC.

Directors & Officers Loss Notice. On April 28, 2006, plaintiffs' lawyer received an email from PNC Bank rejecting a settlement offer from the Warrens to settle all claims against them. In that email, PNC Bank wrote:

> The proposal is rejected. The Warrens have substantial liability to PNC ($700,000 plus claims I've outlined in prior correspondence with you) and cannot buy out for $100,000. PNC intends to press all of its claims against the Warrens. . . .

Email dated April 28, 2006, from Leo Plotkin of PNC Bank to Thomas Muzilla. On May 3, 2006, Federal Insurance sent a letter to Prime Measurement's insurance broker, Hylant, acknowledging receipt of the electronic claim and requesting "any additional pertinent information or documentation regarding the facts and circumstances of this matter." Letter dated May 3, 2006, from Sandra Abair of Chubb Group to Buffy Thomas of Hylant of Indiana. On May 17, 2006, Federal Insurance sent an email to plaintiffs' counsel

requesting certain documentation concerning the litigation on the guaranty and specifically requesting "[c]opies of any and all correspondence regarding the matters referenced in [PNC Bank's] March 22, 2006, letter." Email dated May 17, 2006, from Federal Insurance to Thomas Muzilla. On May 19, plaintiffs' counsel provided to Federal Insurance the documents concerning the litigation on the guaranty, but did not enclose the April 28 email from PNC Bank regarding rejection of the settlement offer. There is nothing in the record to indicate that any further correspondence or communication transpired between Federal Insurance and plaintiffs, plaintiffs' attorney or plaintiffs' insurance brokers at Hylant until August 8, 2006, when Federal Insurance notified plaintiffs of the denial of coverage. Federal Insurance denied coverage because the policy did not cover the cognovit guaranty filed by PNC Bank against plaintiffs.

On June 27, 2007, after a lengthy court-ordered mediation process, plaintiffs and PNC Bank settled all claims between them for $350,000. The Settlement Agreement expressly provides that PNC Bank "alleges that [plaintiffs] committed certain malfeasance while officers and/or agents of Prime . . . ." and indicates that $300,000 of the $350,000 payment was allocated to "claims asserted by PNC . . . for accounting irregularities . . . ." and $50,000 as settlement on the guaranty. Settlement Agreement between PNC Bank and John Warren and James Warren, dated June 27, 2007.

Several months after the settlement was completed, plaintiffs filed suit in Ohio state court against Federal Insurance for breach of contract (Count I), bad faith (Count II) and Declaratory

Judgment on enforceability of the policy (Count III). Federal Insurance removed to federal court based on diversity jurisdiction, 28 U.S.C. § 1332, where it argued that plaintiffs are simply attempting to escape a liability by converting a personal debt based on their suretyship contract into an insurance indemnification claim, as the district court also recognized when it noted:

> The Court is somewhat disturbed that plaintiffs are seeking insurance coverage for the *vast majority* of the amount paid to PNC pursuant to the settlement agreement. It is surprising, to say the least, that so little of the amount was designated as payment under the guaranty, even though that claim is undoubtedly easier to litigate. This is especially so given that PNC did not even assert a claim for accounting malfeasance.

Dist. Ct. slip op. at 12 n.5 (emphasis in original).

The district court bifurcated plaintiffs' bad faith claim (Count II) from the other two claims and stayed all discovery relating to the bad faith claim. The breach of contract and declaratory judgment claims were decided on summary judgment in favor of defendant. *Warren v. Fed. Ins. Co.*, No. 1:07 CV 3695 (N.D. Ohio Aug. 21, 2008). Plaintiffs appeal (1) the grant of summary judgment in favor of Federal Insurance on the breach of contract and declaratory judgment claims, (2) the bifurcation of the proceeding below, which precluded discovery on the bad faith count unless coverage was established and (3) the decision of the district court to prohibit depositions of

Federal Insurance employees who made the decision to deny coverage.

II. Discussion

A. Breach of Contract/Declaratory Judgment Count

Plaintiffs claim that Federal Insurance breached its contract by not defending and indemnifying plaintiffs in their dispute with PNC Bank. The relevant language in the policy provides as follows:

> The Company shall pay Loss on behalf of Insured Persons resulting from any D&O [directors and officers] Claim first made against such insureds during the Policy period, or any applicable Extended Reporting Period, for Wrongful Acts, but only to the extent the Insured Organization does not indemnify the Insured Person for such Loss.

A "D&O Claim" is defined, in relevant part, as follows:

> (a) *written demand for monetary damages* or non-monetary relief;
> (b) a civil proceeding commenced by the service of a complaint or similar pleading;
>
> ***
>
> against an insured for a Wrongful Act, including any appeal therefrom.

Section I(D)(1)(a), (b) (emphasis added).

Plaintiffs argue that the March 22nd letter from PNC Bank to plaintiffs constitutes a "written demand for monetary damages" under subpart (a) of the definition for a "D&O Claim." Federal Insurance argues that the letter states only that PNC Bank is "evaluating" its options and makes no "demand for monetary damages." The relevant portion of the March 22nd letter provides as follows:

> [W]e believe that the Warrens were responsible for misrepresentations regarding Prime's inventory which affected (a) the borrowing base certificates provided to PNC, and (b) Prime's financial statements upon which PNC relied. We are currently evaluating PNC's rights and remedies with respect to these misrepresentations.

The district court agreed with Federal Insurance, finding that the March 22nd letter is not a D&O Claim as that term is defined in the policy. The lower court explained that PNC Bank could not be "currently evaluating" its rights and remedies and "making a claim for monetary damages" because the two concepts are "mutually exclusive." D. Ct. slip op. at 7. The district court also found that the plain language of the March 22nd letter does not contain a demand for monetary damages as required for coverage under the policy. *Id.* We agree.

Plaintiffs also point to cases where they contend that Federal Insurance covered a policyholder in the same or very similar circumstances to this case and argue that Federal Insurance is estopped from denying coverage in this case. We agree with the district court's conclusion that the cases cited by plaintiffs are

different from the situation herein because the language relied upon by plaintiffs in the other cases is decidedly different from the language in the March 22nd letter. None of the cases where coverage was provided cite to language that indicates a party was still "evaluating its rights and remedies."

In the court below, plaintiffs also argued that the underlying suit by PNC Bank on the guaranty involved allegations of financial malfeasance that were "intertwined" with the claim based on the cognovit guaranty, thereby constituting a claim under subpart (b) of the policy as well, but it appears that they have abandoned that theory on appeal.[2] Plaintiffs also contend that the district court erred in refusing to consider other evidence offered by them *after* the claim was denied by Federal Insurance because such evidence demonstrates that PNC Bank did in fact make a "written demand for monetary damages" against plaintiffs during the spring of 2006.

The other evidence on which the Warrens rely, (1) the affidavit of Wallace Clements, Senior Vice-President of PNC Bank, (2) the April 4, 2007,

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[2] In their Reply Brief, plaintiffs state: "Federal argues that Section II(D)(1)(b) of the Policy does not apply. . . . However, the Warrens have not [ever] asserted that this provision provides them with coverage." Reply Brief at 15 n.4. Despite this claim, plaintiffs did in fact argue below that the alleged misrepresentations constitute a Directors & Officers Claim under subpart (b). Memorandum in Support of Plaintiffs' Motion for Partial Summary Judgment at 15 (Heading entitled "The Wrongful Act Constitutes a 'D&O Claim' Under Section II(D)(1)(b)") . The district court addressed plaintiffs' argument that it was entitled to coverage under subpart (b) at pages 10-11 of its opinion below.

letter from PNC Banks' attorneys regarding settlement and (3) the settlement agreement between the Warrens and PNC Bank, which was executed in June 2007, were not in existence during the spring and summer of 2006 when Federal Insurance was reviewing the claim. These documents only came into existence *because* Federal Insurance denied the claim. For example, plaintiffs argue that an affidavit by a PNC Bank officer did not constitute an inadmissible legal conclusion and should have been considered by the district court even though the affidavit stated that the March 22 letter from PNC Bank to plaintiffs served as a "written demand for damages" under the policy. Plaintiffs also point to an April 7, 2007, letter wherein PNC Bank estimated its loss due to plaintiffs' malfeasance at $3.5 million and plaintiffs claim that Michelle Lafferty, an employee of Hylant (the Warrens' local insurance broker), sent an email to Michael Joyce, the Federal Insurance employee who signed the denial letter, wherein Ms. Lafferty says that she and Mr. Joyce discussed "their impression" that Mr. Joyce only reviewed the PNC Bank complaint on the cognovit guaranty when preparing the denial letter and did not review the March 22 letter. Such extrinsic and after-the-fact "evidence," none of which Federal Insurance received before denying the claim, does not serve to turn the March 22 letter into a "written demand for monetary damages" or serve as adequate notice to Federal Insurance that a claim had been made against the plaintiffs that would be covered under the policy.

B. Plaintiffs Did Not Give Notice to Federal Insurance of a "Potential Claim"

Plaintiffs argue that Federal Insurance should have known from the correspondence it received that a potential claim had been made against them by PNC Bank, even if it did not meet the definition of a "D&O Claim." The policy addresses coverage for potential claims that arise during the policy period but do not come to fruition until after coverage has ended. To the extent that later documentation, for example the April 28, 2006, email sent to the plaintiffs by PNC Bank, or other correspondence or circumstances, presented evidence that PNC Bank's "evaluation" of its rights and remedies had ripened into an actual claim, it does not appear that Federal Insurance received actual notice of a "D&O Claim" as required under the policy. By simply informing Federal Insurance that an investigation into plaintiffs' conduct was underway and might lead to more claims against them, plaintiffs did not comply with the policy terms.[3] Under (A)(1),

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[3] The policy provides, in pertinent part, as follows:

VII. REPORTING

(A) Solely with respect to any Liability Coverage Section:

> (1) Any Insured shall, as a condition precedent to exercising their rights under any Liability Coverage Section, give to the Company written notice as soon as practicable of any Claim.
>
> (2) If during the Policy Period . . . an Insured becomes aware of a Potential Employment claim or Potential Third Party Claim which could give rise to any Employment Claim or Third Party Claim . . . or becomes aware of

plaintiffs were obligated to provide notice of the *actual* claim when it arose.

The policy provisions on notice and reporting ensure that Federal Insurance has the necessary information to evaluate whether coverage is warranted when a policyholder makes a claim. Plaintiffs concede it was "a very fluid situation" between them and PNC Bank during the time in question (Plaintiffs' opening brief at 25), but yet they did not keep Federal Insurance apprised of all of the circumstances and correspondence regarding the situation despite Federal Insurance's request in its May 17 letter that they provide all relevant correspondence regarding the litigation with PNC Bank. The changing nature of the situation did not absolve plaintiffs from giving Federal Insurance actual notice of the claim and ensuring that

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> circumstances which could give rise to any Claim, other than an Employment Claim or Third Party Claim . . ., and gives written notice of such Potential Employment Claim, Potential Third Party Claim or circumstances to the Company as soon as practicable thereafter but before the expiration or cancellation of this Policy, then any Claim subsequently arising from such Potential Employment Claim, Potential Third Party Claim or circumstances shall be considered to have been made against the Insured during the Policy Year in which [such claims] or circumstances were first reported to the Company.
>
> * * *
>
> VIII. NOTICE
>
> (A) Any notice to the Company . . . shall designate the Coverage Section under which the notice is being given and shall be treated as notice under only the Coverage Section(s) so designated.

the company had all the details of the "very fluid" situation.

Plaintiffs also contend that the district court erred in its refusal to consider the April 28 email sent to plaintiffs by PNC Bank, even though plaintiffs essentially concede, as the district court found, that there is no evidence that the email was ever sent to Federal Insurance by plaintiffs. The email provides, in relevant part,

> The proposal [for settlement] is rejected. The Warrens have substantial liability to PNC ($700,000 plus claims I've outlined in prior correspondence with you) and cannot buy out for $100,000. PNC intends to press all of its claims against the Warrens . . . .

Plaintiffs contend on appeal that the failure to consider the email improperly "shifts the burden" of proof to plaintiffs because Federal Insurance failed to notify them before denying their claim that additional information was required. However, on May 17, Federal Insurance sent an email to plaintiffs' attorney requesting "[c]opies of any and all correspondence *regarding the matters referenced in [PNC Bank's] March 22, 2006, letter*." (Emphasis added.) Two days later, plaintiffs' attorney sent Federal Insurance a letter and enclosed various documents regarding the litigation between PNC Bank and plaintiffs, but failed to mention or provide a copy of the April 28 email. It was plaintiffs who failed to give Federal Insurance all the necessary documentation, as specifically requested by Federal Insurance on May 17, almost three months before it issued the denial letter. Under the terms of the policy and pursuant to the specific request by

Federal Insurance in May, it was incumbent upon plaintiffs to ensure that Federal Insurance had actual notice of a claim before the denial letter was issued in August.

It is in the interests of both the plaintiffs and PNC Bank to set up Federal Insurance as a source of payment for the suretyship obligation, and the settlement agreement between PNC Bank and plaintiffs reflects that joint interest. But in situations of this kind, we must be conscious of these interests and require strict compliance with the insurance contract before shifting payment to the insurance company for what appears to be a personal debt that the insurer has not agreed to reimburse.

C. Bad Faith

Plaintiffs contend that the district court erred in bifurcating the bad faith count of their complaint from the coverage issues. We review the district court's decision to bifurcate the bad-faith claim and stay discovery while the breach of contract claim is pending for abuse of discretion. *Smith v. Allstate Ins. Co.*, 403 F.3d 401 (6th Cir. 2005); *Gettings v. Building Laborers Local 310 Fringe Benefits Fund*, 349 F.3d 300, 304-05 (6th Cir. 2003) (reviewing a stay of discovery for abuse of discretion). Because the merits of the bad faith claim depended on whether coverage was properly or improperly denied, it was reasonable for the district court to resolve the coverage question before allowing the bad faith claim to proceed.

For the foregoing reasons, the judgment of the district court is affirmed.

APPENDIX B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

No. 1:07 CV 3695
JUDGE PATRICIA A. GAUGHAN

[Filed August 21, 2008]

John Warren, *et al.*,	)
	)
Plaintiffs,	)
	)
vs.	)
	)
Federal Insurance Co., *et al.*,	)
	)
Defendants.	)
	)

Memorandum of Opinion and Order

INTRODUCTION

This matter is before the Court upon Defendant Federal Insurance Company's Motion for Summary Judgment (Doc. 20) and Plaintiffs' Motion for Partial Summary Judgment (Doc. 21). Also pending are Defendant's Motion to Strike Portions of the Affidavit of John Warren (Doc. 24) and Defendant's Motion to Strike the Affidavit of Wallace Clements Or, in the

Alternative, to Strike Statements Contained in Paragraphs 4-10 Thereof (Doc. 25). This is an insurance dispute. For the reasons that follow, Defendant's Motion for Summary Judgment is GRANTED and Plaintiffs' Motion for Partial Summary Judgment is DENIED. The motions to strike are DENIED as MOOT.

FACTS

Plaintiffs, John and James Warren, filed this lawsuit against defendants, Federal Insurance Company and Chubb Group Insurance Co.[1], alleging entitlement to insurance coverage. The facts of this case are largely undisputed and only those facts necessary for a resolution of the instant motion are set forth herein.

Plaintiffs, through a limited liability company, owned a 50% interest in BIS Holdings, LLC ("BISH"). The George F. Hofmeister Family Trusts ("Hofmeister") owned the remaining 50%. BISH is a holding company that held all of the membership interests in Prime Measurement Products, LLC ("Prime"). Plaintiffs were officers and directors of both BISH and Prime.

On February 24, 2004, Prime obtained a revolving line of credit from PNC Bank, N.A. ("PNC"). Plaintiffs each signed a personal guaranty. The personal guaranty contained a cognovit provision, which is tantamount to a confession of judgment. In addition,

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[1] This case was removed to this Court from state court. Prior to removal, plaintiffs voluntarily dismissed Chubb from this lawsuit.

BISH obtained a comprehensive insurance policy from defendant. The policy covered BISH and its subsidiaries, including Prime, and was effective from July 1, 2005 through August 1, 2006. The policy provided directors and officers ("D&O") liability coverage.

It appears that in May of 2005, plaintiffs' interest in Prime ceased. Plaintiffs continued to serve as officers of Prime until July 25, 2005, after which Hofmeister controlled the company. Shortly thereafter, PNC advised plaintiffs that certain events of default occurred pursuant to the revolving line of credit. As such, PNC demanded that plaintiffs fulfill their obligations under the guaranty. Plaintiffs refused and, in January of 2006, PNC filed a complaint in state court. The complaint contained only six paragraphs and sought payment on the guaranty. There were no allegations relating to any alleged misrepresentation or other improper actions on the part of plaintiffs. Because of the cognovit provision in the guaranty agreement, judgment was automatically entered against plaintiffs in the amount of $700,000. In February of 2006, plaintiffs sought a stay of execution on the judgment and subsequently sought to vacate the judgment.

On March 22, 2006, PNC sent plaintiffs a letter regarding various issues relating to the dispute. The vast majority of the letter addresses issues relating to the guaranty. In addition, however, the letter states as follows,

> In addition to your clients' liability to PNC as set forth above (under the guaranty and with respect to the purchase of their interest in BIS

> Holdings) we believe that the Warrens were responsible for misrepresentations regarding Prime's inventory which affected (a) the borrowing base certificates provided to PNC, and (b) Prime's financial statements upon which PNC relied. We are currently evaluating PNC's rights and remedies with respect to these misrepresentations.

On April 6, 2006, plaintiffs' counsel sent a letter to Prime indicating that PNC had provided written notice alleging that plaintiffs were responsible for misrepresentations. In essence, the April 6th letter outlined the allegations in PNC's letter of March 22nd. It appears that Prime contacted Hylant, an insurance broker, regarding the contents of the letter. Shortly thereafter, Hylant notified defendant through its electronic claim system. The notification essentially reiterates the contents of the April 6th letter. Defendant contacted plaintiff's counsel and requested certain information, including copies of the guaranty agreement and court pleadings. On May 16, 2006, plaintiffs' counsel sent a second letter to Prime regarding insurance coverage. In that letter, counsel indicates that plaintiffs are incurring defense costs related to PNC's allegations regarding financial misrepresentation. It is not clear whether Prime forwarded this letter to defendant. On May 19, 2006, plaintiffs' counsel sent defendant a letter enclosing the requested information. In addition, the letter states that the court documents "demonstrate that in defense to this litigation, the [plaintiffs] are incurring defense costs to address matters that are intertwined with the matters associated with PNC's allegations that the [plaintiffs] misrepresented certain financial information. . ."

On August 8, 2006, defendant denied coverage. Defendant took the position that the state court complaint states a claim for breach of contract. Because it does not allege anything constituting a "wrongful act" under the policy, coverage was not available. In addition, defendant claimed that the cognovit nature of the guaranty also precluded coverage. Because PNC need only execute on the judgment, and plaintiffs were prohibited from raising any defenses, the signing of the guaranty amounted to a breach of the policy provision prohibiting settlement without defendant's consent.

Ultimately, PNC and plaintiffs entered into mediation and resolved the underlying dispute. The settlement agreement expressly provides that PNC "alleges that [plaintiffs committed certain malfeasance while officers and/or agents of Prime...." In addition, the settlement agreement indicates that of the $350,000 payment, $300,000 was allocated to "claims asserted by PNC...for accounting irregularities...."[2]

Thereafter, plaintiffs filed this lawsuit asserting three claims for relief. Count one is a claim for breach of contract. Count two is a claim for bad faith and count three seeks a declaratory judgment. The parties cross-move for summary judgment and both motions are opposed.

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[2] Plaintiffs present evidence, largely in the form of affidavits, indicating that the underlying litigation between PNC and plaintiffs included PNC's claims of malfeasance. Defendant moves to strike various parts of the affidavits of John Warren and Wallace Clements, a vice-president of PNC. The Court, however, need not reach these motions for a resolution of the parties' motions for summary judgment.

STANDARD OF REVIEW

In accordance with Federal Rule of Civil Procedure 56(c), summary judgment is appropriate when no genuine issues of material fact exist and the moving party is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986); *LaPointe v. United Autoworkers Local 600*, 8 F.3d 376, 378 (6th Cir. 1993). The burden of showing the absence of any such genuine issues of material facts rests with the moving party:

> [A] party seeking summary judgment always bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any," which it believes demonstrates the absence of a genuine issue of material fact.

Celotex, 477 U.S. at 323. A fact is material only if its resolution might affect the outcome of the lawsuit under the governing law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

Once the moving party has satisfied its burden of proof, the burden then shifts to the nonmoving party pursuant to Federal Rule of Civil Procedure 56(e), which provides:

> When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of the adverse party's pleadings, but the adverse party's response, by

> affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party.

In ruling upon the motion, the court must afford all reasonable inferences and construe the evidence in the light most favorable to the nonmoving party. *Cox v. Kentucky Dept. of Transp.*, 53 F.3d 146, 150 (6th Cir. 1995); *United States v. Hodges X-Ray, Inc.*, 759 F.2d 557, 562 (6th Cir. 1985). However, summary judgment should be granted if the party bearing the burden of proof at trial does not establish an essential element of its case. *Tolton v. American Biodyne, Inc.*, 48 F.3d 937, 941 (6th Cir. 1995) (citing *Celotex*, 477 U.S. 317).

ANALYSIS

1. Breach of contract/declaratory judgment

The insuring clause of the policy provides as follows,

> The Company shall pay Loss on behalf of the Insured Persons resulting from any D&O Claim first made against such Insured Persons during the Policy Period, or any applicable Extended Reporting Period, for Wrongful Acts, but only to the extent the Insured Organization does not indemnify the Insured Person for such Loss.

The parties do not dispute that plaintiffs are "Insured Persons" or that the loss occurred during the "Policy Period." Rather, this dispute centers on

whether a "D&O Claim" was made. A "D&O Claim" is defined, in relevant part, as follows,

> (a) a written demand for monetary damages or non-monetary relief;
>
> (b) a civil proceeding commenced by the service of a complaint or similar pleading;
>
> * * *
>
> against an Insured for a Wrongful Act, including any appeal therefrom.

Plaintiffs argue that the March 22nd letter from PNC to plaintiffs, which was forwarded to defendant, constitutes a "D&O Claim" as defined under subpart (a). In addition, plaintiffs are claiming that the underlying lawsuit involved allegations of financial malfeasance that were intertwined with the claim on the cognovit guaranty. Therefore, they argue that a "D&O Claim" was made pursuant to subpart (b). Defendant argues that neither of these constitutes a "D&O Claim" for purposes of defense coverage or indemnity. Each will be addressed in turn.

March 22nd letter

The March 22nd letter provides as follows,

> In addition to your clients' liability to PNC as set forth above (under the guaranty and with respect to the purchase of their interest in BIS Holdings) we believe that the Warrens were responsible for misrepresentations regarding Prime's inventory which affected (a) the borrowing base certificates

> provided to PNC, and (b) Prime's financial statements upon which PNC relied. *We are currently evaluating PNC's rights and remedies with respect to these misrepresentations.*

(Emphasis added).

Plaintiffs argue that this letter constitutes a "demand" for "monetary damages." Defendant, on the other hand, claims that the letter unequivocally provides that PNC has not yet made a demand for monetary damages. Because the letter indicates that PNC is "currently evaluating" its rights, the letter cannot be a current demand. In reply, plaintiffs argue that in a lawsuit brought in Pennsylvania, defendant argued that language similar to that contained in the March 22nd letter constituted a "D&O Claim."

Upon review, the Court finds that the March 22nd letter is not a D&O Claim as that term is defined in the policy. On its face, the language plainly provides that PNC is "currently evaluating" its rights and remedies. If PNC is "currently evaluating" its rights, it logically follows that PNC has not yet made a demand in that the two concepts are mutually exclusive. In addition, the plain language does not contain a demand for "monetary damages," either explicitly or implicitly. Further, the Court has reviewed the language at issue in the Pennsylvania lawsuit and concludes that it is markedly different from the language contained in the March 22nd letter.[3]

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[3] For example, the letter at issue in that lawsuit provides, "our clients individually and collectively have suffered serious damage.... If you are interested in an amicable resolution of these

Therefore, defendant is not estopped from asserting that the March 22nd letter is not a "D&O Claim."

Plaintiffs also argue that the March 22nd letter cannot be viewed in a vacuum. According to plaintiffs, PNC sent an email to plaintiffs on April 28th, which confirmed that PNC's March 22nd letter constitutes a "D&O Claim." The April 28th email provides, in relevant part,

> The proposal is rejected. The Warrens have substantial liability to PNC ($700,000 plus claims I've outlined in prior correspondence with you) and cannot buy out for $100,000. PNC intends to press all of its claims against the Warrens....

According to plaintiffs, this email indicates that PNC has, in fact, made a demand against plaintiffs. In addition, plaintiffs point to the affidavit of one of PNC's representatives, who testifies that PNC "made a claim" against plaintiffs in the March 22nd letter. The Court rejects plaintiffs' arguments. Plaintiffs fail to provide any evidence that the April 28th email was provided to defendant. Moreover, PNC's affidavit, which characterizes the March 22nd letter as a "claim," is a legal conclusion that is not admissible.

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issues, please contact me immediately. Otherwise, we will proceed to protect the interests of our clients and to seek the full measure of damages...." Unlike this letter, the March 22nd letter provides that PNC was still evaluating its rights and remedies.

Plaintiffs also argue that the policy contains a provision regarding potential claims. The policy provides,

> VII. Reporting
>
> (A) Solely with respect to any Liability Coverage Section:
>
> ***
>
> (2) If during the Policy Period..., an Insured...becomes aware of circumstances which could give rise to any Claim..., and gives written notice of such...circumstances to the Company as soon as practicable thereafter but before the expiration or cancellation of this Policy, then any Claim subsequently arising from such...circumstances shall be considered to have been made against the Insured during the Policy Year in which the...circumstances were first reported to the Company.

Plaintiffs argue that, to the extent that the correspondence received by defendant did not meet the definition of "D&O Claim," the correspondence satisfies this provision. According to plaintiffs, the policy does not dictate what plaintiffs must do after notifying defendant of a potential claim. As such, the policy must be construed against defendant and in favor of plaintiffs. Defendant argues that plaintiffs omit the first paragraph in the preceding section, which expressly states that plaintiffs must provide notice of any Claim. Thus, even if the correspondence falls within subpart (2), which addresses potential future claims, plaintiffs were nonetheless obligated to

provide notice of the *actual* claim when it arose. Because plaintiffs failed in this regard, plaintiffs' argument must be rejected.

Upon review, the Court agrees with defendant. The provision relied on by plaintiffs addresses a situation whereupon an insured is aware of a potential claim, but no actual claim is made during the policy period. In such a situation, the insured may give written notice of the potential claim and, in the event the potential claim ripens into an actual claim, the policy will provide coverage even if the actual claim is made outside of the policy period. Defendant is correct, however, that there is no provision that excuses an insured from the policy provision requiring notice to defendant of the *actual* claim. The reporting provision explicitly requires that an insured "as a condition precedent to exercising their rights under any Liability Coverage Section, give the Company written notice as soon as practicable of any Claim." Thus, even accepting plaintiffs' argument that the correspondence constitutes notice of a potential claim, plaintiffs fail to provide any evidence that they notified defendant of PNC's actual claim. Accordingly, the argument is rejected.

The underlying lawsuit

Plaintiffs argues that PNC made a "D&O Claim" against them under Subpart (b) of the Policy's definition, which requires a "civil proceeding commenced by the service of a complaint or similar pleading...against an Insured for a Wrongful Act...." Plaintiffs argue that, although the complaint states only a claim on the cognovit guaranty, PNC intertwined this claim with allegations of accounting

malfeasance. As such, plaintiffs argue that the definition of "D&O Claim" is satisfied. In response, defendant argues that the complaint clearly states a claim that is not covered under the policy. As such, defendant properly denied both defense and indemnity coverage.

It is well settled that "the duty to defend need not arise solely from the allegations in the complaint but may arise at a point subsequent to the filing of the complaint." *City of Willoughby Hills v. Cincinnati Ins. Co.*, 459 N.E.2d 555, 557 (Ohio 1984). However, this duty only arises if, on the face of the complaint, the allegations state a claim that is either "potentially or arguably" covered under the policy. *Wedge Products, Inc. v. Hartford Equity Sales Co.*, 509 N.E.2d 74, 76 (Ohio 1987). *See also, Holloway Sportswear, Inc. v. Transportation Ins. Co.*, unreported, 58 Fed. Appx. 172, 174 (6th Cir. 2003); *Motorists Mut. Ins. Co. v. National Dairy Herd Improvement Ass'n, Inc.*, 750 N.E.2d 1169, (Oh. Ct. App. 10th Dist. 2001)(no duty to look beyond complaint where complaint contains no claim even arguably covered under policy). Thus, unless the complaint contains a claim that is either arguably or potentially within the scope of coverage, the trial court may not go "beyond the four corners of the complaint" to determine whether a duty to defend exists.

In this case, the underlying complaint contains one cause of action. It is undisputed that the claim asserted by PNC consists of a suit to recover pursuant to the cognovit guaranty. There are no other claims or allegations contained in the underlying complaint. In the briefing regarding the instant motions, plaintiffs admit that there is no coverage for this claim. The

Court concludes that the allegations in the complaint do not state a claim either "arguably or potentially" within the scope of coverage. As such, defendant had no duty to defend.

Plaintiffs argue that the claim for accounting malfeasance was "intertwined" with the claim on the cognovit guaranty. According to plaintiffs, Ohio law imposes a duty to defend where at least one claim is covered, even if the other claim is wholly beyond the coverage of the policy. Plaintiffs, however, point to no case law in which the "covered claim" is a non-pled claim that is wholly unrelated in any way to the claim actually asserted. The Court concludes that Ohio law would not impose a duty to defend in such a situation. This is especially so given that the claim PNC actually asserted against plaintiffs sought recovery under a cognovit guaranty, which, by definition, includes a confession of judgment.[4]

Having concluded that plaintiffs' claim for failure to defend lacks merit, the Court also finds that plaintiffs are not entitled to indemnification for the $550,000 they allege constitutes the "loss."[5] Plaintiffs

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[4] Because the underlying complaint does not state a claim even arguably covered under the policy, the Court need not reach whether the affidavits of John Warren and Wallace Clements are proper. Regardless of how the parties characterized the state court lawsuit, the underlying complaint simply does not state a claim for which there is arguably a duty to defend. Therefore, under Ohio law, the Court need not consider evidence outside of the four corners of the complaint in order to make a determination as to defendant's duty to defend.

[5] The Court is somewhat disturbed that plaintiffs are seeking insurance coverage for the *vast majority* of the amount paid to

make no new arguments in support of indemnification that were not already rejected by the Court in the context of defendant's duty to defend. Accordingly, defendant is entitled to summary judgment on counts one and three of the complaint.

2. Bad faith

Defendant moves for summary judgment on count two of the complaint. According to defendant, in the event the Court concludes that no coverage exists, the bad faith claim should be dismissed. Plaintiffs do not oppose defendant's motion as to bad faith. As such, defendant is entitled to summary judgment on count two.

CONCLUSION

For the foregoing reasons, Defendant Federal Insurance Company's Motion for Summary Judgment (Doc. 20) is GRANTED and Plaintiffs' Motion for Partial Summary Judgment (Doc. 21) is DENIED. Defendant's Motion to Strike Portions of the Affidavit of John Warren (Doc. 24) and Defendant's Motion to Strike the Affidavit of Wallace Clements Or, in the Alternative, to Strike Statements Contained in Paragraphs 4-10 Thereof (Doc. 25) are DENIED as MOOT.

IT IS SO ORDERED.

PNC pursuant to the settlement agreement. It is surprising, to say the least, that so little of the amount was designated as payment under the guaranty, even though that claim is undoubtedly easier to litigate. This is especially so given that PNC did not even assert a claim for accounting malfeasance.

/s/ Patricia A. Gaughan
PATRICIA A. GAUGHAN
United States District Judge

Dated: 8/21/08

APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CASE NO. 1:07 CV 3695
JUDGE PATRICIA A. GAUGHAN

[Filed August 21, 2008]

John Warren, *et al.*,	)
	)
Plaintiffs,	)
	)
vs.	)
	)
Federal Insurance Co., *et al.*,	)
	)
Defendants.	)
	)

Judgment Entry

This Court, having GRANTED Defendant Federal Insurance Company's Motion for Summary Judgment (Doc. 20), hereby enters judgment in favor of defendant and against plaintiffs.

IT IS SO ORDERED.

/s/ Patricia A. Gaughan
PATRICIA A. GAUGHAN
United States District Judge

Dated: 8/21/08

APPENDIX D

U.S. DISTRICT COURT
NORTHERN DISTRICT OF OHIO (Cleveland)
CIVIL DOCKET FOR CASE #:
1:07-cv-03695-PAG

John Warren, James K. Warren,)
Plaintiffs,)
)
vs.)
)
Federal Insurance Company,)
Chubb Group Insurance Co.,)
Defendants.)
)

* * *

Date Filed	#	Docket Text:
5/28/2008		**Order[non-document]:** Defendant's Motion for Protective Order Precluding and/or Postponing the 30(b)(6) Deposition of Federal Insurance Company and the Deposition of Michael Joyce is Granted.[15] Approved by Judge Patricia A. Gaughan on 5/27/08.(D,MB)

* * *

APPENDIX E

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 08-4448

[Filed February 17, 2010]

JOHN J. WARREN, ET AL.,	)
	)
Plaintiffs-Appellants,	)
	)
v.	)
	)
FEDERAL INSURANCE COMPANY,	)
	)
Defendant-Appellee.	)
	)

ORDER

BEFORE: MERRITT, CLAY, and McKEAGUE, Circuit Judges.

The court having received a petition for rehearing en banc, which was circulated to all active judges of this court, none of whom requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the

petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

/s/Leonard Green
Leonard Green
Clerk